BANKING REFORM—DISCUSSION

J. H. Hollander: I am in agreement with Professor Kemmerer as to the wisdom of the two amendments which he proposes to the Aldrich bill. I dissent from him as to the adequacy of such modifications to materially reduce the present dead weight of public opposition to any thoroughgoing plan of banking reform. Instead of discussing, therefore, the essential features of such reform —centralized reserve, a discount market, and asset currency—as to the wisdom of which we appear to be in accord, it seems best to consider the causes responsible for the prevalent indifference and to suggest a possible remedy.

There are two conceivable methods by which banking reform in the United States may be achieved. The first might be defined as the cataclysmic or panic method, being the possibility of securing legislation in the frightened desperation of an industrial panic or in the period of dull prostration which succeeds. As a mode of procedure, it is open to all of the indirection and waste of Elia's method of preparing roast pig—and to something of its uncertainty. On more than one occasion experience has shown that panic leads to the swift adoption of a remedial device, but unfortunately of a wrong one. The other method is the slower, more prosaic one of popular education and effective propaganda.

Since the close of the Civil War, currency and banking have been intermittently the subjects of public discussion in the United States. This stretch of fifty years falls roughly into three overlapping periods. From 1865 to the resumption of specie payments in 1878, we were concerned with the problems growing out of inconvertible fiat money. From the demonetization of silver in 1873 through the years of silver purchase to the definitive adoption of the gold standard in 1900, the issue turned upon the question of a monetary standard. From the submission of the "Baltimore plan" in 1894 to the present time, attention has centered upon the revision of our banking system with particular regard to note circulation.

In each such period of discussion, three elements of the community have been directly involved: (1) the law makers, acting reluctantly or under the stress of personal bias and moving in the right course only in deference to an irresistible public mandate; (2) the banking fraternity, representing a definitely vested inter-

est and an immediate class concern, except in so far as members thereof have risen to a more general responsibility; (3) the general public, comprising industrial, mercantile, and agricultural classes—in the main inert and inarticulate, aroused with great difficulty into any consciousness of concern, but imperious in demand when so aroused.

The same conditions figure in the present juncture. The banks of the country are likely to move in the direction of banking reform only to the limited extent that their executives have risen above their professional environment. As bankers they are restrained by a trade inertia, by the reasonable profitableness of the existing system, and by a characteristic underestimate of future trouble. The prospect of relief through legislative initiative is no less remote. The divergence of sectional, social, and economic interests, the mischievous identification of committee chairmanship with proprietary authorship of each particular plan, the comfortable avoidance of moot legislative issues—all suggest that banking reform will come to the legislative fore only when public sentiment has crystallized so emphatically that delay means political suicide.

It is from the third direction that relief must proceed. The public mind must be drilled into an intimate and insistent consciousness of direct involvement. This must take the form of bringing home to each element of the country the specific loss and peril to which it is exposed by the present banking system. In this campaign of education the political economists of the country must play a much larger and a more expert rôle than they have hitherto assumed. They must by further inquiry and new analysis make clearer and more accessible very many practical aspects of our banking system of which little is said because less is known,—the inconvenience to the industrial and mercantile community of an exaggerated seasonal drain, the present expensive substitutes for the discount of bills receivable, the crude mechanism by which the rate of foreign exchange is fixed, the increasing repressive effect upon commercial borrowing of security holdings by banks of discount.

Leroy D. Peavey: Reviewing the subject of banking reform as indicated by Mr. Kemmerer's paper, he agrees, as do nearly all close students, that the plan is well worthy of adoption. There is little doubt in the minds of many that, among numerous other

advantages, the mobilization of the reserves and the opportunity for banks to re-discount at stated rates would be altogether beneficial to the country. The slow headway which such a plan has made, which slowness Mr. Kemmerer has enlarged upon, is to be lamented. Possibly the thing needed to secure its adoption is another 1907 panic. Certainly the fair business conditions of the last year or so have caused the people to forget that an efficient monetary system is as much needed to *prevent* panics as it is to *remedy* them.

It has come to me almost first-hand that Mr. Aldrich wishes suggestions and criticisms, and welcomes any attitude which will insure the passage of some law which will better our present monetary system. As Mr. Aldrich states, this plan, comprising the best features of all banking systems, has been evolved after a prolonged and laborious study by competent men, and it is quite generally agreed that the slowness of its adoption is due to the fear that some one class of people will get control of it to the detriment of the country.

Mr. Kemmerer states that there is apprehension lest bankers or certain interests called the "money trust" shall get control. Is it not also true that the merchants and farmers of the great West wish to have control of this system? Again, there is another point which Mr. Kemmerer has not mentioned,—namely, that some believe the government should be in control. On good authority I think I may say that President-elect Wilson believes the banking system should be controlled from Washington.

As to Mr. Kemmerer's suggestion concerning the directorate, this is a hard matter to decide. There is some truth in the objection that a board of nearly fifty members is an unwieldly thing, and, on the whole, I am inclined to agree with him that a smaller board, and one elected in a more democratic way, as he suggests, will cause the bill to be looked upon with more favor.

In spite of the safeguards which this plan provides, however, does there not still remain a wide range within which the directors of the Association may expand and contract credit at their own discretion? All are generally agreed that the responsibility intrusted to these directors would be very great. Even if the Association should never be exploited for private ends, there are very responsible questions to be settled. The question is not only one of good *intentions*, but of good *judgment*. None who are familiar with the complexity of the problem can believe for a moment that

it is not a difficult thing to regulate credit in the manner suggested. For one reason, the human equation cannot be eradicated; directors representing business interests might instinctively desire expansion as a stimulant for trade; bankers also might be similarly influenced, while ex-officio government directors might be inclined in the same direction, feeling that expansion is a feather in the cap of the administration. Moreover, the public might persistently urge the drivers of the great machine to "let it out another notch!"

Finally, even though we disregard such dangers as the above, we cannot escape another momentous consideration, namely, that the National Reserve Association is not designed as a mere emergency measure, a sort of buffer at the extreme peak of a boom and the very bottom of a depression, but a permanent institution, the duty of which is to keep credit steadily on a normal line parallel to the average growth of the country. I think a part of the opposition to the Aldrich plan has been due to the failure of the public to appreciate the great fact that the object of maintaining a National Reserve Association is not to ameliorate panic conditions, but rather to prevent such crises altogether by keeping credit continually normal. In other words, the true mission of the Association is not *palliative*, but a *preventative;* it is not a *safety valve* but a *governor*. Those men therefore are greatly in error who suggest that we do not need the banking and currency reform because we already have the Emergency Act. They have missed the real purpose of the plan.

The interest rate is, in the last analysis, the bone of contention, being the throttle of business. Various classes of people wish to be the governor which controls this throttle, but the interest rate of the nation should be based on business conditions as a whole. In the paper on *Statistics and Politics* read before the Statistical Association the other day, I explained in some detail how a composite plot or graphic of business conditions, such as the copies for distribution at the door, will give at all times an approximately exact idea of just how business is at any given time. I have not time here to explain how this particular graphic is made, but would refer to the published record of the paper in the regular journals of the American Statistical Association.

Suffice it to say that this is a composite plot of such subjects as Immigration, New Building, Failures, Bank Clearings, Commodity Prices, Surplus Reserves, Foreign Money Rates, Domestic Money

Rates, Condition of Leading Crops, Idle Cars, Political Factors, and Stock Market Conditions. Now, instead of any one class of people controlling interest rates, should not these rates be determined from a study of such a composite plot, increasing according to a definite scale as the country develops an area of prosperity, and decreasing according to the same scale as business declines to form an area of depression below the line of average growth of the country? To my mind this would remove much of the prejudice against the Aldrich plan, as such a scale could be determined definitely and made satisfactory to all classes of people. Moreover, the amount of notes outstanding could be adjusted to a similar scale, rising automatically as an area of prosperity begins to form, and falling automatically whenever an area of depression develops below the average line of growth for the country.

Surely this will eliminate many perplexing problems, allay prejudice, and give a working basis for a bill modeled along the lines of the scheme which Mr. Aldrich has proposed, which bill I am very much in favor of. It seems to me that the sliding scale of money rates and notes outstanding as above suggested will practically settle the question of control, and remove many of the objections to the plan.

O. M. W. Sprague: Professor Kemmerer is to be congratulated on the plan of organization which he has devised for the control of the machinery needed to make possible coöperative action among the banks. He has attacked the chief obstacle which has been encountered in the effort to secure banking reform legislation—the widespread fear that greater power over money and credit might be secured by a few banks and bankers in the money centers, and particularly by those of New York City. Professor Kemmerer's plan has the enormous advantage of being far more simple than that adopted by the National Monetary Commission. Under the plan of the Commission it is most unlikely that control would ever be acquired by particular groups or classes of banks; under Professor Kemmerer's plan this possibility would be even more remote. But this is not its chief virtue. It is conspicuously a better plan because it makes more obvious, more intelligible, the impossibility of undesirable control over the proposed Reserve Association.

But while a method of selecting the directorate which shall give

the people confidence in the Reserve Association is essential if legislation is to be secured, it is also essential that the board of directors shall be made up of men of unusual foresight, conservatism of temper, and strength of purpose. But the plan of organization of the Monetary Commission and that of Professor Kemmerer are unsatisfactory in this respect and necessarily so. This is an inevitable consequence of the necessity of making sure that the board of directors shall fairly represent the different interests, and the different sections of the country. An honest and fair-minded board we may secure through ingenious legislative devices regarding its selection. But to secure the choice of men with the necessary experience and firmness of purpose to handle the difficult questions which will come before them is not possible by means of statutes alone. Experience with the workings of the Reserve Association will in time provide rules of action suitable for most contingencies, but at the outset the problems confronting the management will be both novel and exceedingly complex. For these reasons it would seem desirable that the power of the Reserve Association to extend credit should be no greater than is clearly necessary for the main purposes for which the institution is to be established. Moreover, the vague distrust on account of which detailed provisions for choosing the directorate are devised will be lessened if the institution itself is to be one with distinctly limited power over credit. I feel, therefore, that my part in this discussion will be in line with the spirt, even if not with the content, of the opening paper if I venture to indicate reasons for thinking that the powers of the Reserve Association may be limited more definitely than they were in the measure formulated by the Monetary Commission or in most public discussions of this subject.

It is commonly assumed that a cash reserve of 50 per cent of demand liabilities, including both notes and deposits, would ordinarily be maintained by any institution set up in the United States in which was lodged the responsibility for the maintenance of the cash foundation of the credit structure. The resources of such an institution would be derived in part from government balances which it may be assumed would generally amount to at least $100,000,000 and from the balances of the other banks, deposits which may be expected to amount to $500,000,000. With these resources and without any power to issue notes whatever, several hundred millions of loans could be granted before the reserve would be brought down to 50 per cent of liabilities. If the exist-

ing note-issue of the banks were taken over, a part of the cash held would be absorbed as a reserve against them, but any further right of issue would greatly increase the power of the Reserve Association to extend credit before the reserve was brought down to the 50 per cent point. This is because of the large volume of one of the kinds of paper money now in circulation—the gold certificates. In the ordinary course of business gold certificates would be received by the Reserve Association, and if instead of paying them out they were retired and the notes of the Reserve Association were used in their stead we may expect that in the course of a few years its notes would have pretty completely taken the place of the gold certificates in the hands of the people. To this substitution there could be no objection if the additional reserve money thus secured were not made the basis for additional loans. But with the view generally held that a reserve of 50 per cent is quite large enough, the management of the Reserve Association would be subjected to enormous pressure to extend loans in periods of active business. Can we be sure that we shall have a management wise enough and strong enough to withstand such pressure?

Aside from the increase in lending power due to the ordinary growth of the banks generally, it is distinctly undesirable that there should be any considerable increase in the supply of funds available for short-time loans in this country. At present and aside from seasonal requirements, the supply of short-time loans is quite as great as can be safely employed in present business dealings. Possibly an excessive amount is now employed in collateral loans and perhaps a slightly greater amount of commercial loans could be utilized without extreme hazard. Some such change as this in the relative proportion of the two classes of loans is likely to follow the establishment of the Reserve Association if its re-discounts are restricted to commercial paper. But to increase greatly the total of bank loans will be certain to result in disaster through the increased reliance upon short-time loans for objects the funds for which should be secured from permanent investors.

I would suggest that the power of the Reserve Association to issue notes be limited to an amount not exceeding 25 per cent of its cash holdings. This would permit all the increase in our paper currency which can, from any point of view, be regarded as desirable. It would also be likely to impress upon the management of the Reserve Association, and upon the people generally, the importance of carefully husbanding its resources so as to be in position

to meet seasonal and emergency requirements. This restriction would also be likely to keep the total volume of loans made by the Reserve Association within moderate limits in ordinary times. The institution would then be a less powerful factor in the business world, less liable to be subject to popular distrust.

There need be no fear that a limited right of issue would so weaken the Reserve Association as to defeat the purposes for which banking reform is desired. The facilities which an institution such as the proposed Reserve Association can provide for making settlements between the banks and for the transfer of funds between different parts of the country will tend to make far more uniform requirements for the use of the cash reserve of the several banks. With greater stability in reserves the lending power of the banks will also be more stable, thus lessening the need of resorting to the Reserve Association for re-discounts. Past experience in crises in which banks have suspended payments should not be taken as a measure of cash requirements after the Reserve Association has been established. A fundamental purpose of all plans of banking reform is to escape suspension in future. This will be largely accomplished by such an institution as the Reserve Association, not by paying out an indefinitely large quantity of its own notes, but through the power which it will have by the granting or withholding of re-discounts to insist that the other banks make full use of their own reserve instead of hoarding large amounts in excess of reserve requirements, as has been the practice of many banks in former crises.

An institution which shall make a comparatively small amount of loans in ordinary times and which shall need to make no very considerable additional loans even in emergencies can accomplish practically all of the results desired by those interested in the improvement of our banking system. It can do this through arrangements for making payments between banks in different sections of the country, thus providing the same service which is performed by clearing houses for banks in particular places. Its functions would be largely of a routine nature, so that its establishment would be unlikely to occasion distrust or alarm in any section of the country.

E. E. Garrison: There is no other subject so vital in business economics, government, or industrial relations as proper banking functions.

When Professor Kemmerer says, "It is not disapproval of the functions assigned to the proposed National Reserve Association that has rendered the so-called Aldrich plan unpopular," he is, in my opinion, entirely mistaken.

It is the unsound, unfair, and uneconomic functions which were proposed to be invested in the National Reserve Association that have defeated that plan so far, and will continue to defeat it.

If the proper functions were provided and all improper functions proscribed, the country at large would accept almost any form of organization, because the average man can easily be made to see that no organization or influence could divert these functions from their beneficent, normal operation. In other words, we must create an institution whose possible activities are so carefully prescribed and so accurately circumscribed that what should be done will be done, and nothing else can be done, or can happen. We must get away from the theory that any group of men, no matter how assembled, will be wise enough, honest enough, or powerful enough to create and maintain the proper functions, and only the proper functions, when sitting as a board of directors of an institution of re-discount, reserve, and issue.

The vital thing in the whole question of banking is the relation of relative volume of medium exchange to prices of commodities, and when I speak of "medium of exchange" I mean deposit currency, as well as other forms.

To grasp this greatest consideration in the whole matter, it becomes necessary to learn the lesson of history, and particularly of the history of our own country during its periods of unsound banking, including the period from 1866 to the present time. This lesson is very simple and very obvious to the careful student, and can be briefly summed up as follows: any form of banking which gets too far away from the issue of medium of exchange (including most of the deposit currency) upon, and only upon, evidences of actual contemporaneous exchange of currently produced commodities, will result either in inflation or contraction; and in one case will enhance prices faster than money wages, and in the other case will contract prices, discourage legitimate activity, and throw labor out of employment.

It will here be necessary only to refer to conditions at the time of Shay's rebellion; to the influence of both confederate and government issues during the Civil War, and to the fact that during the past fifteen years, when prices have been rising beyond all

precedent, the volume of gold has increased from eight hundred million to a figure 70 per cent greater than that, while deposits have increased from seven and a half billion to a figure 100 per cent greater than that, which would be equivalent to 940 per cent increase in the volume of gold in circulation. It can be accepted as axiomatic that anything which the people will accept generally in exchange for labor and commodities at a fixed ratio to some other commodity, gold, will have the same effect upon prices as increase in the volume of gold itself in circulation, and will continue to have that effect until an offsetting premium on gold appears. This would not be true if, as the old-fashioned economists believed, a dollar of inflation always drove a dollar of good money out of the country; the slack is not taken up that way. The slack is taken up by an increase in the prices of commodities, and particularly so under the tremendous centralized and efficiently financed organizations commonly spoken of as "trusts," which, to a greater or less degree, monopolize the power of price making, even when they do not monopolize the output of the commodity in question.

The only method that has ever been discovered, or probably ever will be discovered, since the medium of exchange was originally invented for the confusion of man's mind, which even approaches, albeit imperfectly, an approximation of the current volume of all forms of medium of exchange to the actual needs of legitimate business, and thereby to a noninflating and noncontracting volume, is the method which, in so far as possible, confines all issues of denominational paper currency to re-discount for the banks by a government controlled central institution of strictly defined short-time commercial acceptances arising from the actual exchange of commodities representing the best credits in the world, that is, commercial credits, and floated through banks and a banking system controlled in a preventive rather than a curative way by a premium upon commercial banking over investment and speculative banking. This premium need be nothing more than a preference on the part of the central institution in making its rediscounts in favor of those banks which, when stress upon the money market arises, can be shown to have invested the larger proportions of their assets in real commercial banking.

This does not involve any hardship to legitimate investment banking; it does place a decided handicap upon purely speculative banking. Furthermore, such an institution should be subject to

the constant study of a commission of competent economists, whose only purpose should be, with these facts in mind, to watch the effect of banking in all its branches upon commodity prices, and to communicate with the central institutions of reserve and issue in all other countries upon this subject.

There is no legitimate function of a central institution which cannot be amply provided for without breaking away from the fundamental principles referred to.

The objection to this strict definition of the functions of a central institution has been made that it will take a considerable time for the business men of the country to create an adequate volume of commercial acceptances. There is no foundation for this objection, since the volume of good book accounts in the country is at any time several hundred times as large as is necessary to meet any condition that might arise; and upon the first appearance of money stringency every business man in the country would willingly draw and accept short-time bills if they could be properly liquidized. In fact, one of the most essential things to provide for in such an institution is some contraction at the outset of our present enormous volume of medium of exchange, as a safety valve against too sudden an influx of commercial paper into the banking machinery.

To see where the so-called Aldrich plan not only fails to provide the necessary functions, but actually provides for very dangerous possibilities of further overexpansion of our medium of exchange, it is only necessary to read clauses 26, 27, 28, 31, and 32. Clauses 26 and 27 provide inadequate and unduly cumbersome re-discount of commercial paper; clause 28 provides that in the face of a stringency the banks may discount their direct obligations secured by "satisfactory securities;" clause 31 provides that the banks may accept drafts "properly secured," and then, in very vague terms, adds, "arising out of commercial transactions;" and clause 32 "that the Reserve Association may buy from the banks acceptances of banks or of acceptors of unquestioned financial responsibility," and vaguely again adds, "arising out of commercial transactions." This vague expression "arising out of commercial transactions" is by no means an adequate definition of strictly defined short-time commercial acceptances covering the actual exchange of commodities, and any practical man of affairs knows that the money-making motive is strong enough in the American people to lead both business men and bankers to

stretch such a clause in normal times and to forget it entirely in times that are not normal.

Briefly stated, what we need is to provide the function of issue based upon the re-discount of strictly defined commercial paper, partly because that function will produce equilibrium in the financial world, and partly because it will go farther than any other one influence toward preventing unnatural price variations. Its influence upon prices is partly positive and partly negative, in that it facilitates the exchange of commodities when such facilitation is most needed, and it prevents investment and speculative activities from interfering with such exchanges by monopolizing the money market; in other words, it is the only system which will bring us to what Jevons a long time ago called "a perfected state of barter."

Given a proper delimitation of functions, the only consideration, from the standpoint of organization, is that it should be politically sound,—that is, so constituted as to merit and win the confidence of the people. It makes little difference, given proper functions, whether the institution be a privately owned central bank under adequate government supervision, or whether it be a government commission or a national council. Such functions as have been here described could not be much distorted either through ignorance or interest, and any distortion of them would be so patent that it would be easily checked and its originator readily brought to punishment.

The Aldrich plan, mainly through the unsound functions that it provides, at once aroused the suspicions of thousands of business men who, like myself, have had the experience of being able to borrow in Wall Street on a ten-point margin, to carry speculative stocks time and time again, when they were unable to borrow a cent upon a much better and safer form of credit, namely, obligation of the buyer to the seller represented by good book accounts easily convertible into commercial acceptances.

There were other vital defects in the Aldrich plan, principally in the appearance of exclusiveness in its relations with the banks of the country, but also in its creation of an enormous corporation with countless subsidiary corporations all over the country which should hold all the financial activities of government in one hand, and the operation of all subscribing banks in the other, for a term of fifty years, with a very limited government influence provided by Section 58, which reserves the right to Congress to alter or

amend, but not to revoke, and that only at the end of each decennial period, and which grants the President power to select the governor from a list of three nominated by the capital-elected board.

For purposes of comparison and in order to make clear the possibility of building a plan on sound lines which shall provide everything necessary, Professor Scott, of the University of Wisconsin, and I have prepared a revision of the Monetary Commission's plan, copies of which are here for distribution.

In conclusion, I desire to say that, in my opinion, it is not the prejudice of the American people against a central issue rediscount and reserve institution which has defeated the Aldrich plan. On the contrary, it is the defects in the Aldrich plan—I had almost said the vicious provisions contained in it—which have intensified what prejudice formerly existed and aroused new ones. If currency reform has suffered a setback in the last two years it is because the only plan that has received wide circulation and been generally discussed has made a bad impression upon many thinking men.

I do not believe that currency reform has suffered a real setback. The Aldrich plan has done a good work in showing the people what kind of an institution we should not have, and the business world is more alert today for a right plan than it has ever been since Andrew Jackson crushed the second central bank by offering to the state politicians the bribe of the distribution of the national surplus, and to the state banks an equally tempting bribe in the form of the deposits of the national reserves. A really sound plan will be received by the business men of the country with enthusiasm and with more intelligence than would have been the case immediately after the panic of 1907.

E. W. Goodhue: It is rather surprising that the people of this great country have been so long content with the present banking system. The National Banking Law has remained, for a period of almost fifty years, substantially unchanged.[1] In the meantime population has increased, new industries have been developed, large corporations organized, foreign trade has steadily grown and become increasingly important, methods of doing business have changed, the South and West are making larger and larger

[1] Cf. J. L. Laughlin, *Banking Reform,* p. 1. (National Citizens' League 1912.)

demands upon the banks for credit and currency, and the products of the nation have increased rapidly both in quantity and value. Because of these industrial changes a greater burden and responsibility has been placed upon the banks.

For the past ten years there has been in certain circles a thorough discussion of the defects in our banking system. Various propositions have been made for remedying these defects, which range all the way from slight modifications of our present law to a central bank of the European kind. The National Reserve Association plan with branch and local associations is now definitely before the country. The aim of this plan is to bring about coöperation between the nearly twenty-five thousand banks in this country, to centralize the resources of these banks, and to add new machinery which will promote banking efficiency in normal times. This plan is the result of the most thorough study into banking conditions which has ever been made in this country. Presumably it is scientific, nonpartisan, and so far, at least, as its functions are concerned well adapted to meet modern conditions.

Our experience in the panic of 1907 proved conclusively that a system of independent banking breaks down in times of crisis. Because of this recent experience interest has chiefly centered in the problem of strengthening the banks so that they may be better able to stand the strain of a crisis. In general very little attention has been paid to the weakness of our system in normal times. If the National Reserve Association, or any other scheme of centralization which might be adopted, should remedy the banking defects of this country in times of crises, in my judgment, it would do so in part because the banks would be able to meet more fully the growing demands made upon them in normal times.

Recently, Mr. Harry A. Wheeler, President of the Chamber of Commerce of the United States of America, commenting on our banking system said:—"We have a fair weather banking system. It works all right in good times, but it breaks down just at the time when it is most needed—in a period of financial distress."[2] This statement fairly represents the idea which quite generally prevails in the country. In the minds of the people at large the defects in times of crises have overshadowed and almost obscured the defects in normal times. But to those who have studied our system carefully there are grave doubts in regard to the fair weather character of the system. When the country is most

[2]See *New York Times,* December 1, 1912, p. 6.

prosperous our banks are not able to meet the complex demands made upon them. We are familiar with the money and credit stringency during the crop moving period which has given rise to the demand for an elastic currency. We are, perhaps, somewhat less familiar with the disadvantages of our Independent Treasury System; the discriminations against one of our most reliable assets, namely the paper which is backed by agricultural products; the relative immobility of funds in the United States; the heavy commissions paid foreign acceptance houses; and the non-negotiable character of our prime commercial paper.

During the present year from September 14 to December 14, with the exception of the week from October 12 to 19, there has been a loss each week to the sub-treasury by the New York Clearing House Association banks of sums varying from $1,945,000 to $10,423,000. The total loss for this period of thirteen weeks was $68,842,000.[3] This loss was coming just at the time when the South and West demanded funds, and compelled the New York banks to shift loans, engage gold abroad at high rates and look for deposits from the government. Agricultural loans, in which some of the most reliable assets of this country are offered as security, are made at high rates. The average ranges from 7 to 9 per cent as against 3 to 4 per cent for the same class of loans in Europe. The foreign trade of the United States has grown enormously, and legitimately ought to become of more and more importance year by year. At the present time our foreign trade aggregates about $4,000,000,000 annually,[4] and in order to finance this trade we are compelled to pay millions of dollars to London, Paris, and Berlin banking houses for the acceptance of our bills drawn against commercial letters of credit.[5] These illustrations constitute a part of the evidence that our system is not adapted to the changed commercial and industrial conditions in this country; that it is not even a fair weather system.

The financial legislation of the last fifty years has done little to remedy defects in normal times. Some real or fancied emergency has forced the political party in power, almost on the spur of the moment, to frame and pass a currency measure. A war, a

[3] *New York Times,* September 14 to December 15, 1912.

[4] *New York Times,* December 1, 1912. Article by Harry A. Wheeler, "Our Banking System Fails Under Strain of Bad Times," p. 6.

[5] Cf. Paul M. Warburg. "The Discount System of Europe", p. 9. (*Report of National Monetary Commission.*)

crisis, an impending party defeat at the polls has been the chief factor in the passage of our currency and banking laws. Legislation has been hammered out in Washington to save the party's face, or as a price paid for the passage of some favorite measure. Moreover in the struggle to meet the real or fancied requirements of an emergency, economic or political, the bill actually passed has been riddled with compromise, and has shown all too well the effects of party bickering and bartering. We have only to point to the National Bank Act of 1863, the Sherman Act of 1890, the recent Aldrich-Vreeland Act to illustrate the effects of emergency in the legislation relating to banking and currency reform. The National Bank Act was a war measure, the Sherman Silver Purchase Act was the price paid for the McKinley Tariff measure,[6] the Aldrich-Vreeland law was a sop thrown at the asset currency advocates.[7] Under the political conditions which have prevailed in the past, a scientific banking law would be a practical impossibility. Once the National Monetary Commission's bill gets into Congress it will, I fear, go the way of many another good public measure. Either it will be lost in committee or else will be subject to such party compromises that most of its great public functions will be altogether destroyed. In the presence of no great demand for changes to meet day to day needs, party exigency, vote swapping, and political intrigue will work havoc with the bill.

The people of the country know little about a scientific banking plan. The name "Aldrich" constitutes, in the country at large, a much stronger argument than the intrinsic advantages to the business community of the National Reserve Association plan. The average farmer or merchant is not able to form a judgment of the new scheme for banking reform on its own merits. The vocabulary of banking is likely to be incomprehensible to him. Acceptance, discount, mobilization of reserves, asset currency are almost meaningless terms. In many cases the farmer and merchant do not see in just what way the plan is going to benefit them. They look upon it as a scheme originated by bankers to benefit bankers. The mere fact that the National Reserve Association is to be a bankers' bank is a telling argument against it.

[6] Cf. Noyes, *Thirty Years of American Finance,* p. 151.

[7] Cf. J. L. Laughlin, "The Aldrich-Vreeland Act," *Journal of Political Economy,* Vol. 16 (1908), pp. 489-513.

The average man fails to take account of the many features which will reduce the expense and delay in doing business.

Not only are the farmers and merchants at sea in regard to this new plan of banking reform, but the average lawyer, physician, clergyman, teacher in the schools, and even professor in the colleges, with the exception of the economists and some few others, know little in regard to the real merits of the bill proposed by the National Monetary Commission. The functioning of the scheme, its adaptibility to the changed commercial and industrial conditions, has not attracted the attention of the intelligent classes in the United States. Bankers and experts in the field of economics see deeper than the name "Aldrich" or "banker's bank;" but I fear that a meritorious plan of banking reform is likely to be thrown aside because the average citizen sees nothing in it but a scheme to still further intrench the so-called "money trust." The public is quiescent and unconcerned; the panic of 1907 is a thing of the past; our people put up with the inconvenience and expense of a poor banking system without complaint; they are used to it, the force of custom is strong upon them, and they do not clearly see the defects which make our system so out of harmony with modern business conditions. Real public sentiment—the kind which would force Congress to enact a scientific banking law—is largely lacking.

The National Citizens League and the American Banker's Association have made commendable efforts to educate the people along banking reform lines. Large sums of money have been spent in propaganda, and yet the work of education has but just begun. So far as the present plan is concerned there are four facts which stand out clearly:

1. The public (average citizen) needs to understand something about the great fundamentals of banking.
2. The public must see how the National Reserve Association will strengthen the banks in times of crises, and through the banks the commercial and industrial interests of the nation.
3. The public must be able to see the importance of this new plan in meeting the day to day needs of the business community.
4. The public must look past the name "Aldrich" and "bankers' bank," and support or refuse to support the plan upon its real merits in solving the difficult problems of modern banking reform.

ROYAL MEEKER: I think it is all-important that we do not

exaggerate the importance of our differences and minimize the importance of our agreements on the question of banking reform. If each insists upon standing aloof and refuses to surrender any part of his own pet plan, we never shall agree upon any plan of reform, and, consequently, perhaps no banking reform will be carried through, or if reformation is effected the economists will have contributed nothing thereto. I for one do not wish to see Congress enact a banking measure to which economists shall have contributed only confusion of counsel and mutual condemnation. I believe it is possible to harmonize the apparently conflicting views expressed here this morning. I believe Mr. Garrison exaggerates the distance between his plan and the plans suggested by the other speakers. I agree with him that there are two kinds of banking extant in the world today. I should not designate these two classes just as Mr. Garrison does. I do not think we can describe banking systems as Scotch, Irish, Dutch, English, or French. The Scotch banks, as a matter of fact, do not take care of commercial and industrial credits in any different manner or any more effectively than do the banks of Ireland, England, Canada, Germany, or France. In fact the Scotch banks are a part of the great English banking system. The two different kinds of banking in existence may be best described as (1) coördinated, systematized, centralized banking, and (2) disorganized, chaotic, decentralized banking. We have the latter kind; every economically civilized country has the other kind. We all desire to systematize and civilize our banking system. Mr. Garrison differs from others who have spoken only in degree. He wishes, I take it, to connect our banking system more closely with the industry and commerce of the country. He seems to assume that the miscalled "Aldrich bill" was not designed to accomplish these desirable results. It must not be forgotten that Mr. Aldrich is not the author of the "Aldrich bill." He had about as much to do with framing that measure as I had. The bill is the work of many experts, laboring faithfully through many months. None of these experts have any axes to grind. Nearly all who have studied the Monetary Commission's bill critically agree that it will accomplish just those results emphasized by Mr. Garrison pretty satisfactorily. Why cast the work of the Monetary Commission to the four winds just because the gentleman from Wisconsin doesn't like the name Aldrich? I believe it possible to draw up a measure that will meet Mr. Garrison's criticisms so far as they are valid, and secure the

support of all serious students of banking and currency. It is important that every economist who has made a special study of banking should state his views frankly and defend them valiantly in debate. It is even more important that all approach the subject of banking reform in a spirit of conciliation, prepared to give up many pet theories in order to secure the main features of reform which we all favor. Surely banking reform is more important than any particular individual's scheme for banking reform. By means of conferences and conciliations, giving a little here and taking a little there, the economists of the country should agree upon a plan of banking reform which would meet with the approval of all and present a practicable plan for legislative action.

John R. Commons: I am surprised at the complacency with which those who have presented their papers have accepted the economic part of the Aldrich bill. They have simply taken for granted that there are no "jokers" in the bill and that its use of terms is such that it would really become an aid to the commercial activities of the country as against the speculative interests. Instead of a discussion on these features of the bill, they have presented merely different schemes to make the bill more appetizing to the people, by making it more democratic in its organization. I should think that, as economists, we should more carefully examine the economic features rather than the political features of the bill. It is there that we should search for anything that, under the guise of elastic currency for commercial purposes, would let in speculative securities. This is the point that Professor Scott and Mr. Garrison have undertaken to correct in the bill which they have drawn as a substitute for the Aldrich bill.

Arthur S. Dewing: I had no intention of commenting on this topic and am impelled to do so now merely because I find the whole temper of the discussion in direct opposition to my own attitude toward the problem. At the present time there is a popular clamor to increase the control of governmental agencies over business. A single Central Reserve Association, the administrative details of which would lie largely in the hands of political appointees, is merely, in my opinion, one aspect of this tendency. We seem to forget the tremendous self-adjusting power of business. We like to delude ourselves into thinking we can shift the responsibilities which are ours on to the shoulders of a socialized organ-

ization of some kind. But in the five minutes at my disposal I have no intention of delivering a polemic against the plan of a Central Association. I should like, however, to call attention to three distinct points.

First,—a kind of looseness of reasoning in which the advocates of the Central Association are apt to indulge. They point out that in England, France, and Germany there are central banks of some kind, in this country there are none. The panics of 1873, of 1893, of 1907 were particularly severe in this country,—*ergo*, our banking system is at fault. Strange, is it not, that in the two centuries or more in which the Bank of England has been in existence England has suffered many times from financial crises of a most pronounced character. In fact we have only recently come to realize the world-wide seriousness of the panic of 1907. The reference of the last speaker to the alleged fact that interest rates in parts of this country were 7 or 8 per cent, while in parts of Europe they were 2 or 3 per cent, as pertinent to differences in banking systems, is an example of a kind of fallacious appeal to the logical method of agreement and difference which is unfortunate to say the least.

The other two points to which I should like to call to your attention concern two tendencies by which modern business is itself meeting the difficulties of our individualized banking system and our inelastic currency. The first of these is the growing importance of the note-broker. Few people, I think, realize the tremendous volume of commercial paper now negotiated through the intermediary of a broker, for the modern merchant in commercial paper, in his present importance, is of comparatively recent origin. Back of 1892 his activities were more or less localized. At least they did not tend to create a discount market of national scope. But beginning with the returning prosperity of the late nineties, and particularly since the panic of 1907, the business of the note-brokers has assumed national significance. I was recently given statistics which I am not at liberty to make public which indicate that about 1895 there was very little eastern paper discounted in the western market, while at the present time the volume of eastern paper discounted in the South and West is somewhat larger even than the volume of western paper discounted in the East, although this totals, at the present time, to a very large amount. In other words the note-broker, by the distribution of large accounts throughout the country, is creating a discount market

which enables small banks and individual investors in commercial paper to distribute their holdings geographically and among a variety of industries. The growth of the business of the note-broker creates, therefore, a national re-discount market, fortified by competition and private initiative. If this business can be made extensive enough, as is rapidly taking place, it supplies one of the specific advantages offered by a Central Association having re-discount privileges.

The third point which I wished to touch upon, in the minute remaining to me, is the widespread tendency of manufacturing and trading partnerships and corporations to fund a large part of their current liabilities into a mere stock liability which becomes widely distributed among the members of an investing public. Pertinent to this tendency is the numerous issues of 7 per cent preferred stock now being listed on the New York Stock Exchange. Approximately 68 per cent of the new listings are of this class. A manufacturing company, for example, finding the amount of its outstanding notes and bills growing unwieldy, reincorporates in such manner that a large issue of preferred stock is emitted. This is taken by a syndicate of investment bankers and resold in odd lots to an investing public. With the proceeds of the preferred stock issue, the manufacturing company then takes up a considerable part of its discounted bills. As far as finanical condition is concerned, therefore, the company has been strengthened, for a floating liability has been transferred into a permanent capital liability. The corporation becomes less dependent on the money market and less at the mercy of financial crises,—in other words, less affected by fluctuations in the demand for bank accommodation and indirectly less dependent on the elasticity in the volume of currency.

These are but two ways in which business enterprise is adjusting itself to our individualistic banking system, but they are noteworthy and important.

O. W. Knauth: Discussion of the project of a Central Bank naturally divides itself into two parts: its functions, and its control. Professor Kemmerer's study is confined to the latter of these aspects, and it is to this that I would like for a moment to bring back the discussion.

Professor Kemmerer's main contention is that the bank is primarily a social institution; that it concerns not only the bankers,

but all the industries of the country. This analysis of the situation seems to me to be unquestionably correct. But accepting it as a premise, we are brought to the question of the adequacy of the remedy to meet this condition. The Aldrich plan gives to the government but a small minority of representation on the board of directors. Professor Kemmerer proposes to increase the number to eleven out of twenty-eight directors. While a step in the right direction, this is still, however, a minority. A minority is at best a party of protest: sufficient ordinarily, but totally unavailing in times of real stress. The logic of the situation seems clearly to demand that fourteen at least out of the twenty-eight directors be representatives of the government.

In turning to the political situation, we find at least a balance of power as desirable as in theory. Professor Kemmerer has shown that the failure of passage of the Aldrich bill is due to the popular fear that the so-called Wall Street banks will strengthen their control of the monetary situation. How much easier, then, would it be to pass a bill which definitely prevented such control than one which still left a loophole for its realization? Should the banks object to this proposition, they would place themselves in the awkard position of being open to the charge that they contemplated acquiring the control of the bank, and would thus give definite foundation to the present vague fears of the public. In any event, the question of control would be brought into much clearer light than it is today.

To sum up, then, Professor Kemmerer, by applying a remedy which only modifies the present plan, instead of adequately altering it, is open to the charge of shrinking from the conclusion which his own arguments seem to necessitate.

John M. Clark: Just one point with regard to the proposal of Professor Kemmerer for the democratizing of the Aldrich plan to remove popular opinion. One source of opposition which I have met is the indirectness of control of the members over the Central Association. The public nature of the institution has been emphasized, and the analogy of our government has been used. But to find a parallel to the organization of this body, we should have to imagine a system where ward councils selected delegates to boards of aldermen, these boards elected the members of the legislature, and the legislature made up in this way chose our Senate. Considering the popular attitude toward the way our

Senate is elected now, we can imagine what their feelings would be toward any such system of representative and re-representative bodies if anyone were to propose it in the field of government.

I don't presume to say just how this objection should be met, but I do know that it is a source of part of the more intelligent popular opposition which Professor Kemmerer wishes to remove by making all reasonable concessions to it.

EUGENE E. AGGER: I should like to say a word or two concerning "jokers," about which we have heard a great deal in connection with the Aldrich plan. "Jokers" are usually spoken of as resulting from deep-laid plans, all aimed skillfully and secretly to promote the interest of those who devise them. Professor Commons has warned us that we ought to subject the Aldrich scheme to the minutest scrutiny with the idea of uncovering every possible "joker." While not denying the possibility of purely accidental "jokers," and thus while not in the least desiring to weaken the force of Professor Commons's warning, I do consider it necessary to call attention to the fact that a purposeful and skillful planting of a "joker" in such a measure as the Aldrich scheme requires a full and complete understanding of the scheme as a whole and of all its implications; and it is perfectly safe to say that there is not one banker in a hundred who understands banking as an organized system well enough to devise a "joker" that would not be instantly detected. The charge, oft repeated in the public press, that the whole Aldrich plan is a cunningly devised scheme in the interests of Wall Street and the "money trust," is humorously idle. There is an amazing ignorance on the part of bankers as a class of banking as an economic function. They can, of course, distinguish between a promissory note and a mortgage, which capacity is held to be the first requisite of a banker, but there are precious few who can set forth intelligently the requirements of an economical and scientific banking system. I spoke recently about this very matter to one of the most prominent bankers in New York City, one who also enjoys a considerable reputation as a scholar and as a publicist, and he told me smilingly, in answer to a question about the Aldrich plan, that there were very few bankers who really understood that plan, although the farther away from New York you got the more you might possibly find. Then every now and then in the *Wall Street Journal*, and in other financial papers, there are published articles for the

enlightenment of "the Street" that seem to the student to deal with surprisingly elementary points. For example, not long ago there appeared in the *Journal* an article with large headlines that took up the major portion of a column, the whole purpose of which was to set right what was called the erroneous impression of "the Street" that the recently imported gold meant an extension of credit equal to four times the amount of gold imported. The writer of the article gravely explained that against the deposit of the gold itself a reserve of 25 per cent had to be maintained and that therefore the extension of credit could at most equal only four times three-fourths of the amount imported, or just three times the whole amount. Now I submit that those who had to have such an elementary fact expounded to them could hardly devise a very complicated and subtle "joker" that would successfully hoodwink the rest of the country. My own feeling is that we need not worry particularly about "planted jokers," although that does not mean, of course, that we should not be on our guard against the purely accidental kind.

John Harvey Sherman: There are two kinds of "joker": One is the kind that is deliberately planted in a bill with false intentions; the other is the kind of "joker" that the purely academic or purely legal mind discovers in the terminology of the bill after it has become an act. This latter is the kind of "joker" which I believe many of us are afraid of. Surely the gentlemen who advocate the Aldrich plan can have no objection to a thorough examination into the terminology of this bill for the purpose of discovering whether there be any of this kind of "jokers" present. To do so casts no reflection either on the authors of the plan or on those who now advocate it.

E. Dana Durand: I might say that in our work in the Departments, we are often confronted with just this sort of trouble. Court interpretations of enacted laws often make them utterly ineffective through giving them meanings which were entirely unsuspected when the bills were passed.

Professor Kemmerer: The hour for adjournment has arrived and I shall only take time to refer to a couple of points made in the discussion.

Professor Clark makes the point that the plan of organization

is too complicated and the methods of electing directors too indirect. I agree with him that these are defects of the plan, but see no way of avoiding them without bringing in greater evils. It is important that the scheme of organization should be centralized and should be closely knit together. This requires a certain amount of complexity, and of indirection in the methods of election. The scheme of organization which I have proposed is considerably simpler, and more direct than that proposed by the National Monetary Commission.

Mr. Knauth believes that a majority of the directors of the central board should be appointed by the government and should represent the public at large. There is much to be said in favor of his proposition. It is difficult to tell just where to draw the line in apportioning power between the banking community on one hand and the public at large on the other. Any plan which is to be enacted into law will require the support of the public at large and also of the banking interests. It is a case of steering a safe course between Scylla and Charybdis.